

Article

Responsible Investments by Foundations from a Legal Perspective

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I. Introduction

1. A promising and challenging new pattern

The management of foundation assets may, at first guess, promise little fascination: The foundation is assigned a certain capital stock by the founder; this capital stock is then invested very conservatively in, say, public bonds; and the return on this investment – constant and limited as it is – is used by the foundation board to further the foundation purpose. (In this article we will not and cannot engage in a technical definition and delineation of the financial and legal meaning of terms like “asset” and “return” with regard to the foundation sector. Cf., e.g., Fritz 2009, n. 443 et seq.) Yet even if this “conservative” pattern may hitherto have been a correct description of the typical foundation asset handling, it nowadays is losing its descriptive force as realities in the foundation sector begin to change.

Among many other new or increasingly used foundation patterns, there is one that focuses on a specific way to invest the foundation assets, thereby changing our ideas on which role the foundation asset should play in a foundation entity. “Purpose-related investment,” as we may call the pattern, seeks to further a foundation’s purpose by the asset investment itself, not only by the spending of the return on investment. If the specific purpose is to finance investments that fulfill sustainability criteria, we may speak of “sustainable and responsible investments” (SRI).

The potential of this new approach is indeed considerable, as it can, in a certain sense, exponentiate the purpose-realizing power of a foundation: In addition to the revenues from the foundation’s capital stock, the capital stock itself can be used to further the foundation’s purposes. Given the fact that it is the essential duty and trait of a foundation to further its purpose, one may even – at least at first guess – think that purpose-related investing foundations are “the better foundations,” as they further their respective purpose more intensely.

However, the new investment pattern, and in particular the SRIs, can also cause new challenges and problems. Two major examples of these challenges lie in the more technical and economic field of asset management and in the legal field of foundation law requirements for foundation asset investments. As for the asset management dimension, an investment must, in order to qualify as an SRI, fulfill criteria which can vary from one area of SRI to another and which can be very demanding. As SRIs are a relatively new class of investments, the market for

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them is not as developed, well-structured, and well-evaluated as the markets for conventional investments. And SRIs often tend to present greater risks for the investor than conventional investments, e.g. because they are offered by recently established market players or because they are situated in developing countries. As for the legal dimension, the avoidance of risks and losses is directly linked to the problematic foundation law aspects of SRIs. The board of a foundation is obliged to realize the foundation purpose as best it can by spending the return on the foundation asset on purpose-realizing measures. The board therefore, in principle, has to manage the foundation asset in a way that is low-risk and yields high and steady returns. Can SRIs indeed fulfill these requirements?

These economic and legal challenges can only be solved by gaining a precise understanding on what the term “SRI” means, by having recourse to the general principles for the asset management of foundations, and by adapting them to the particularities of sustainable investments. As we will now take a quick look at these core aspects for SRI, two model cases shall help us to understand and apply the relevant legal principles, which are quite complex.

2. Model cases

Let’s imagine two foundations, one facing an *ex ante* and one facing an *ex post* problem related to SRI. A hospital foundation has been given a conventional (i.e., not directly SRI-related) purpose that *inter alia* consists of providing the financial basis for a particular hospital. The board of this foundation considers engaging in an SR investment and would like to know whether it is allowed to do so and what limits it has to observe. This precaution appears to be justified, as a failure of the investment could have disastrous consequences for the foundation: In a worst-case scenario, the hospital (which depends on the financial support of the foundation) would have to be closed down, with all of the employees losing their jobs. In this case, the supervising authority may replace the board and the board members may face liability charges.

A solar foundation, by contrast, has (among other purpose elements) an SRI-related purpose element, namely to advance the use of solar energy. In the pursuit of this purpose, the foundation board has invested in solar field-projects in the Middle East. This investment is risky but it also promises a considerable return on investment. Unfortunately, the investment fails completely due to political disturbances and mismanagement. Now, the foundation board is worried whether it has committed a violation of foundation law.

II. Disambiguation: “Sustainable investment” – What does that mean?

1. Definition of sustainability

Sustainability is one of the most frequently used terms in general and the most popular concept in current social discourse and environmental thinking. Astonishingly, there seems to be no common definition (allegedly, there are more than three hundred definitions; cf. Bonevac 2010, p. 84). It rather appears that the buzzword used by many to evoke so much is so vague as to be virtually meaningless.

The term *sustainable development* emerged in the World Conservation Strategy of 1980 (International Union for Conservation of Nature and Natural Resources 1980) and gained wide recognition when the Brundtland Commission formulated the concept that sustainable development “meets the needs of the present without compromising the ability of future generations to meet their own needs” (World Commission on Environment and Development [informally: Brundtland Commission] 1988, n. 27). Since there are limits to the environment’s

ability to meet these needs, environmental capacity must be preserved in order to satisfy the needs of future generations. The Brundtland statement is the most popular definition of sustainability and still commonly used today.

From an economic point of view, sustainability is understood as the preservation of capital, maximizing the flow of income that could be generated from a given stock of assets or capital while at least maintaining them (Bonevac 2010, pp. 90 et seq.; Pearce and Atkinson 1998, p. 253). Generally three kinds of capital are distinguished: economic (man-made) capital, social (human) capital, and environmental (natural) capital. (The last is sometimes criticized as unquantifiable, but despite the fact that there may be no “right” way to value a forest or a river, it is likely to be wrong to give it no value at all [Hawken, Lovins and Lovins 2010, p. 321]. The ambiguity is that the definition of *natural capital* is as imprecise as *sustainability* is [Norton 2005, p. 310].) To answer the crucial question about possible substitution between the different forms of capital, the concept of weak and strong sustainability has been developed (Daly and Cobb Jr. 1989, pp. 72 et seq.). Weak sustainability counts only welfare and allows unlimited substitution, in particular human-built capital to be substituted for wealth in the form of natural assets. Strong sustainability, in contrast, specifies limits on substitution, requiring that both humanly created and natural capital must be maintained intact separately.

The various definitions and concepts do not sufficiently clarify specific parameters for modeling and measuring sustainability. Besides, it must be kept in mind that a system can only be known to be sustainable *after* there has been time to observe whether a prediction concerning the sustainability of a system holds true (Costanza and Patten 1995, p. 194). Summarizing, the lowest common denominator of the various definitions of sustainability is likely to comprise the elements of future natural capital and economic activities. It seems, thus, that the most appropriate concept of *sustainability* and *sustainable development* is that of a “dialogue of values,” comprising social goals (e.g. justice, participation, and equality), ecological goals (including biodiversity preservation and ecosystem resilience), and economic goals (including growth, efficiency, and material welfare) (Blewitt 2008, p. 27).

2. Sustainable Investments

Sustainability definitions do not provide suggestions about how to implement sustainability within an enterprise or association. Therefore, it is useful to approach the matter by asking fundamental questions regarding economic success in combination with social and environmental responsibility. For example: Do business activities promote sustainable economic health for the company and the global community? Is business conducted in a manner that contributes to the well-being of employees and the global community? Are business operations managed in a way that is protective for the environment? (Blackburn 2007, pp. 22 et seq.). The most widely used framework for sustainability reporting are the Global Reporting Initiative (GRI) guidelines (cf. Ligteringen 2009; see also: <https://www.globalreporting.org>), which present reporting principles and key indicators to measure sustainability performance (Blewitt 2008, pp. 184 et seq.). G3 guidelines, GRI’s latest version, encompass economic elements (e.g. wages and benefits, labor productivity, and investments in training), environmental topics (impacts of processes, products, and services on air, water, land, biodiversity, and human health) as well as social matters (workplace health and safety, employee retention, labor rights, human rights, wages, and working conditions).

Based on the same parameters, the concept of sustainable and responsible investment (SRI) takes into account the long-term economic, environmental, and social risks and opportunities by excluding investments that violate basic international norms or by integrating environmental, social, and governance (ESG) factors in investment analysis and company engagement (Imbert and Knoepfel 2011, p. 10). SRI includes numerous investment approaches.² Positive screening identifies companies whose activities relate to defined industries and/or are best performers on some indicators, whereas negative screening avoids businesses that fail to pass a defined threshold or belong to sectors perceived as having a negative impact on the environment (Imbert and Knoepfel 2011, p. 15). In both cases, selection may be done by excluding or by actively choosing companies with good/bad performance regarding environmental, social, and governance factors. Accordingly, the investment horizon is limited to the companies that have been selected whilst investment decisions are based on traditional financial considerations. ESG factors are also used to determine sustainability performance of companies in relation to and comparison with their competitors (best in class). However, only sustainability leaders meeting also the financial requirements set by the fund manager are selected for investments.

No division between ESG analysis and financial analysis exists when investing directly in companies that create solutions for ESG challenges (e.g. water scarcity) or avoid the consequences of such issues (ESG-integrated investment) (Imbert and Knoepfel 2011, p. 15). In this approach, ESG factors are analyzed alongside traditional company fundamentals, representing an additional set of criteria for investment decisions. Being willing to relax expectations for risk-adjusted financial returns in exchange for substantial and tangible social impacts, investors may also actively provide capital to enterprises that contribute to defined social goals (impact investment).

Eventually, based on a purely financial investment decision, investors can also work directly with companies they are investing in by implementing ESG goals, participating in shareholder resolutions, or reserving the right to disinvest from nonresponsive companies through responsible engagement overlay and active ownership (Fritz 2009, p. 175; Imbert and Knoepfel 2011, p. 15).

III. General principles for investing foundation assets

1. The foundation asset and its management as a core element of the foundation organism

The legal assessment of our topic has to start from the specific role of the foundation asset in the fundamental structure of a foundation. The foundation is a legal entity established by separating assets from the founder and dedicating them to a specific purpose according to the founder's will. The founder, however, maintains in principle no influence on the asset, but depends on the proper execution of his will by the foundation board. Hence, in this structure, the foundation asset is a necessary element, not least because it provides the means to realize the foundation purpose and the will of the founder (Jakob 2006, pp. 61 et seq.). It follows from this link between foundation purpose and foundation asset that the foundation board is by no means

² One important example shall be at least named here: "venture philanthropy" is a foundation concept that has gained much prominence in the recent years; venture philanthropy foundations can be seen, the term being interpreted accordingly, as a particular type of SRI foundation. On venture philanthropy, see Schönenberg 2010.

completely free in the use it makes of the foundation asset. Rather, the management and use of the foundation asset and of its returns have to be oriented towards the realization of the foundation purpose and follow the statutory provisions the founder may have provided (see Jakob 2012, Art. 83 n. 7; Jakob 2006, p. 62). Of course, the foundation board has a certain degree of discretion when it comes to the details of foundation management. This discretion forms part of the so-called autonomy the foundation and its board are endowed with. But autonomy and discretion end where either binding prescriptions are made by the law or the foundation statutes, or where the management and use of the foundation asset deviate from the orientation towards the foundation purpose and the will of the founder (for the concept of foundation autonomy and for its limits, see Jakob 2006, pp. 204 et seq.). If this border is crossed, the actions of the foundation board violate foundation law, can cause the intervention of supervisory authorities, and may inflict liability on the board members.³

2. State of the art: Many open questions

But what are the precise principles and duties that follow from this fundamental relation of asset and purpose, discretion, and binding prerequisites? A synoptic examination of the Swiss, the German, and the Austrian jurisdictions shows that the answer to this question seems far from complete, though some parameters have been sketched from different sides. To name only a few important positions, the Swiss Federal Court, having regarded the application of a couple of legal prescriptions (Art. 49 et seq. BVV 2; Art. 71 BVG; Art. 84 Al. 2 ZGB), regularly holds that the asset management of a foundation needs to be primarily guided by five principles: return, liquidity, asset preservation, diversification of investments, and the avoidance of risks (BGE 124 III 97 E. 2; 108 II 352 E. 5a). These criteria refer more to the *results* of investment decisions and may be seen as part of a result-driven approach. In contrast to this approach the Swiss Foundation Code is an important example of a process-driven approach, which focuses more on the process of decision-making in investment measures.⁴

The process of decision-making also constitutes the focus of another important legal institute, the so-called Business Judgment Rule. This rule was mainly established in the United States, and it is not yet commonly applied in Swiss foundation law. But the experts in Liechtenstein foundation law will know the rule well, as it has been applied, by the Liechtenstein High Court, to Liechtenstein foundations (cf. Beschluss OGH of January 8, 2004, 10 HG 2002.58-39, *LES 2005*, pp. 174 and 178). Furthermore, the Liechtenstein Foundation Law Reform in 2009 has codified the Rule in Article 182 PGR (Jakob 2009, n. 348 et seq.). In its essence, the Business Judgment Rule states that board members cannot be held liable for a decision, even if the decision turns out to be detrimental to the foundation, if the board fulfilled some essential decision making-requirements (Block, Barton and Radin 1998, p. 41). Summarily speaking, these requirements are: (1) The decision in question must constitute a conscious

³ This article does not extensively address liability issues. However, it must be clear to every foundation board member that a violation of the duties that result from foundation law, foundation statutes, and the will of the founder can pose liability risks. The principles and duties explained in this article are therefore of high relevance for liability issues, too.

⁴ The Swiss Foundation Code is a self-regulatory and recommendatory code of conduct (mainly) for grant-making foundations. The Code was initiated by “SwissFoundations,” the Association of Swiss grant-making Foundations, and its first edition was published in 2005 (2nd edition 2009). For the process-driven approach of the Code, see e.g. “Finances,” recommendations 2 et seq., pp. 47 et seq. For a detailed commentary on the Code, see Sprecher, Egger and Janssen 2009.

business decision, i.e. the board must have decided in business-related matters and with a certain margin of discretion; (2) the board must act with due care, i.e. (among other factors) on a well-informed basis; (3) the board must be disinterested and independent, that is to say it must not act in its own personal interest or in the interest of third persons, at least if these interests contradict the interest of the institution that the board represents; and (4) the board is obliged to act in good faith, with the vague concept of “good faith” meaning that the board’s actions must be driven by the best interest of its institution and not by other interests. Whether it should be asked, in addition to these criteria, if the board’s actions constitute an abuse of discretion, is discussed controversially (see Block, Barton and Radin 1998, pp. 85 et seq.). The application of these criteria in assessing a decision does shift, in a certain sense, the focus from the content of the decision to the process of the decision-making – therefore, a certain proximity between this approach and the aforementioned process-driven approach is evident.⁵

Yet these different parameters, and many more academic statements that cannot be mentioned here, have not, for the time being, coalesced into a comprehensive and coherent set of legal rules for the management of foundation assets. And a great number of questions still remain open altogether. This uncertainty is, of course, not very satisfactory for a foundation board that needs to act *today*. To provide at least a basic orientation, we will try to extract some cornerstone legal principles which condition the present legal situation and which will certainly remain of high importance throughout the further development of this area of law. This article, of course, cannot explain or even name all of these cornerstone principles. It will therefore limit itself to highlighting a few that might be particularly relevant.

3. Cornerstone principles

a) Discretion and binding prerequisites – due exertion of discretion

In foundation asset management, the foundation board has, as in every other area of action, to carefully determine where it possesses a margin of discretion and where there exist binding prerequisites, deriving from (mainly) foundation law or from the foundation statutes.

Whereas binding obligations are simply to be effectuated, discretionary decisions demand a considerable degree of care. This is because *discretion* does not mean that the foundation board is free to decide and do whatever it feels disposed to. Rather, the due exertion of discretion is a four-step process (cf. for details of the process Jakob 2012; for examples from the Swiss jurisdiction BGE 100 Ib 132 E. 3; 111 II 97 E. 3): At first, the board has to determine, with regard to a certain issue, the existence of a margin of discretion and the outer limits of this margin which are set by binding legal or statutory prerequisites. Secondly, the board has to assemble the aspects which are relevant for the decision on the issue; and the board has to sort out the aspects which must *not* be considered when making the decision. Although the relevant and irrelevant aspects do, of course, depend very much on the particular issue to decide, some typical aspects are relevant or irrelevant to most decisions. For instance, a typically relevant aspect is the will of the founder; a typically irrelevant aspect is the set of advantages that a board member could draw personally from a particular decision. Once all relevant aspects are sorted, the board has, thirdly, to consider these aspects by weighing up the pros and cons for the

⁵ This paper will not address the differences and relations that exist, in the US jurisdiction, between the Business Judgment Rule and the so-called Prudent Investor Rule, a parallel set of criteria that is applied to the management of trust assets.

different possible ways to decide. And lastly, the board has to take and implement a decision that reflects the result of the consideration process

In the process of gathering the relevant information for a discretionary decision, external expert knowledge comes into play: Because foundation board members will often not possess that knowledge or will at least (rightly) wish to receive some external feedback on their investment decisions, the board will consult external financial advisors. This step is not only understandable, it is also often mandatory for taking due care in the investment decision process (Sprecher, Egger and Janssen 2009, pp. 110 et seq.; Friedrich 2012, pp. 185 et seq., 198 et seq.). Yet, external advisors need to remain what they are – *advisors*. At least with regard to fundamental asset-management decisions, the foundation board is not allowed to delegate the decision to its advisors, and the discretion of the advisors must not replace the foundation board's own discretion.

These rules to be followed for a due consideration process are of very high importance to the management of foundation assets. This is because foundation boards typically possess a margin of discretion with regard to many asset management issues, at least as far as the details of these issues are concerned. And the rules are of high importance to the board members themselves, because if the board fails to follow these steps in exercising its discretion, it might violate foundation law and the board members may be held liable.

b) Two levels of guiding aspects

When it comes to the aspects that are relevant for foundation asset management, and consequently for the due exertion of discretion in this field, two levels of guiding elements can be discerned and may be called “foundation level” and “investment level.”

On the foundation level, we can locate the aspects that derive from fundamental principles of foundation law and from the structure of the foundation. Two core elements of these aspects are the foundation purpose and detailed investment directives made by the founder in the statutory documents of the foundation (Jakob 2006, pp. 61 et seq.; Fritz 2012, pp. 133 et seq.). The foundation purpose can imply targets for the return and for the liquidity that the asset management needs to generate (Sprecher, Egger and Janssen 2009, pp. 105 et seq.). The fact that the asset management is obliged to meet the requirements set by the foundation purpose follows from the foundation law principle that the life and actions of a foundation have to be oriented towards the realization of its purpose; this principle constitutes itself a foundation law aspect on the foundation level. If, for instance, the purpose of a hospital foundation is the maintenance of a hospital, the assets of that foundation needs to be invested in a way that yields current returns high enough to cover the running costs of that hospital. Besides setting the foundation purpose, the founder can make more detailed instructions how to invest and use the foundation capital. For instance, the founder can determine whether a foundation shall preserve its capital stock eternally or whether the foundation can consume its capital stock with the consequence that the foundation is intended to be of a limited duration (Jakob 2006, pp. 58 et seq.). Or, to give another instance, the founder of a foundation may stipulate in the foundation statutes that the foundation capital is to be invested, to a certain extent, in stocks of *local* undertakings.

On the investment level, we can localize general investment principles that apply, in principle, to the management of any assets, not only the assets of a foundation. One example is the principle of investment diversification (cf. Friedrich 2012, pp. 178 et seq.). If, for instance, our hospital foundation must invest twenty percent of its capital in the stocks of local

undertakings, the foundation might be well advised to invest five percent of its capital in each of the four local companies that qualify, rather than investing the entire twenty percent in a single company.

Distinguishing these two levels of guiding aspects for the foundation asset management is not only of a descriptive value. The model also helps to clarify the relation between the aspects assigned to the different levels: As the foundation board is bound to realize the foundation purpose and the relevant will of the founder, the foundation level takes precedence over the investment level. The aspects on the foundation level influence and can even override the aspects on the investment level. In our hospital foundation example, the foundation board can diversify twenty percent of its capital among the stocks of only four companies because these are the relevant local companies and the foundation statutes oblige the board to invest this part of the asset locally; here, the foundation level has influenced the investment-level aspect of investment diversification. And even insofar as the stocks of non-local companies would promise more attractive returns at an acceptable risk, the investment limitation deriving from the foundation level overrides the investment level and prevents the foundation board from diversifying the investment into the stocks of these non-local companies.

Yet the relation between foundation level and investment level is not only that of a one-way dominance. To a certain degree, the investment level can also influence the foundation level. If, for instance, our hospital foundation needs to replace a costly medical instrument in order to continue realizing its foundation purpose, investment-level aspects may lead the foundation board to postpone that replacement until the local companies pay their annual dividends instead of selling stocks at an unfavorable moment.

c) An important example: The taking of risks

The rules on how to manage assets are numerous and complex. We have already referred to the five investment principles that are so prominent in the ruling of the Swiss Federal Court. These principles are important, but they are certainly not the only relevant aspects on the investment level. This article cannot try to draw a complete picture of the relevant aspects and their interconnection. Nonetheless, we would like to point out an example that is of particular interest to most foundation boards: This is the right, or maybe even the obligation, of foundation boards to take risks in the investment of the foundation capital.

It should be considered a truism that every return in the capital markets corresponds to a certain risk – the higher the return, usually, the greater the risk. Yet in the investment policy of foundations, this truism often has seemed to be forgotten, at least in the past. Foundations have been believed to be limited to treasury bonds or comparably gilt-edged fixed-interest investments. But inflation periods, national bankruptcies, or the breakdown of seemingly rock-solid banks have painfully proven that these investments also carry risks – as we are now rediscovering. Due to these experiences and with regard to the principles of modern portfolio theory, the Swiss academic literature (Krauss 2010, pp. 58 et seq.) as well as in the ruling of Swiss Courts (BGE 99 Ib 255 E. 3) now recognize that foundations can and even should take appropriate risks when investing the foundation capital – although this recognition is not yet reflected in the investment behavior of all foundations.

Although the question of what is appropriate in this context is complicated, two core elements would have to be the structure of the particular foundation (foundation level) and the techniques of modern portfolio management (investment level) (Moses, Singleton and Marshall

III 2004, pp. 167 et seq.). If, for example, the foundation purpose allows for planning payouts a long time in advance, the foundation can typically engage in investments like stocks which bear considerable risks in the short run but promise a very good risk-return-ratio in the long run. And portfolio-management instruments, like the combination of investments with different risk profiles or the use of collective-investment vehicles (Aalberts and Poon 1996, p. 59), can help to make this structure-adapted taking of risks successful.

IV. Particularities of SRIs

The general principles for the management of foundation assets are of direct relevance to SRIs by foundations. This assertion may seem self-evident, but it is nonetheless important to keep it in mind. Although SRIs, with their often positive ecological and social effects, constitute a promising field for foundation activities, they are, from a foundation law perspective, not automatically approvable. If an investment violates foundation law principles, this violation does not become excusable just because the investment is an SRI. Hence it is important not to decide on SRI activities without taking general foundation law and investment principles into consideration.

1. Statutory basis for SRI

The relevance of the foundation purpose and of detailed statutory precepts for the asset management of a foundation suggests distinguishing foundations with a statutory basis for SRI from foundations without such a basis. From this distinction results a threefold categorization: (1) foundations with SRI as a purpose element; (2) foundations whose statutes, including the relevant will of the founder, address SRI activities without making them part of the foundation purpose; and (3) foundations whose statutes, including the relevant will of the founder, do not mention SRI activities.

a) Foundations with SRI as a purpose element

For the first group of foundations, engaging in SRIs means to directly realize the foundation purpose. The SRI activity is therefore not only possible but mandatory. However, doubts may arise, for instance, whether the obligation to invest SR only applies to the returns of the foundation's capital stock or also to the initial capital stock itself. The answer to this question can only be found by interpreting the statutes and the will of the founder. It might however be possible to state the general assumption that the capital stock of a foundation with an SRI purpose may not be invested in a way that clearly contradicts the SRI values. In any case, the SRI purpose must, like any foundation purpose, be realized lastingly and in the best possible way by the foundation board. An SRI purpose is by no means a *carte blanche* to waste the foundation capital in idealistic but unduly risky investment ventures. Expert investment knowledge and advice is therefore just as necessary for an SRI-purpose foundation as for any other foundation.

b) Foundations with statutes addressing SRI otherwise

For the second group of foundations, much depends on the way the SRI issue is addressed by the foundation statutes and the will of the founder. We focus here on what may be the most relevant situation: where the foundation board is obliged, by the statutes and the will of the founder, to realize a foundation purpose which does not include an SRI element, by using the returns of an SR-invested foundation asset. In such a case, much depends on how detailed the investment precepts are which are made by the founder in the statutes with regard to the SRI aspect. If the foundation board is told very precisely how to invest, not much margin of

discretion is left, and in principle the foundation board cannot be blamed for unsatisfactory returns which prevent a more intense realization of the foundation purpose. If, by contrast, the foundation board has greater discretion over how to execute SRIs, the two-level structure analyzed earlier comes into play. Under this structure, the foundation purpose, in principle, takes priority over the investment-level aspects. The foundation board must structure the SRIs in a way that best serves the foundation purpose, even if environmental, social, and governance (ESG) factors advocate a different investment structure.

c) Foundations without a statutory basis for SRI

For the third group of foundations, it is not self-evident that the foundation board is allowed to invest SR. Usually, however, the interpretation of the foundation statutes and the will of the founder does not forbid the board from investing along SR aspects. Even so, as SRI has no distinct statutory basis, no negative impact on the realization of the foundation purpose can be justified by SRI particularities. Therefore, if a conventional investment offers a better risk-return-ratio than an SRI, the foundation board of such a foundation may have to opt for the conventional investment.

2. The role of GRI guidelines, ESG parameters, and other decision-guiding aspects

If a foundation board is allowed or obliged to invest SR, it has to make sure that its investments are indeed SR. Here, the aforementioned environmental, social, and governance (ESG) parameters and Global Reporting Initiative guidelines come into play. They help to determine whether an investment is SR; hence, they are major aspects in the foundation board's exertion of discretion over which investments to choose. Reversely, the exertion of discretion may be flawed if the board does not take ESG parameters and GRI guidelines into consideration. In consequence, ESG parameters and GRI guidelines can be of relevance for the due investment activity of the foundation board, as a kind of SRI "soft law" (De Jonge 2008, pp. 103 et seq.; Sulkowski, Parashar and Wei 2008, p. 788). SR-investing foundation boards should therefore build up internal or external expert knowledge on these soft-law parameters. Yet, those parameters are only soft law (i.e. they do not have the same binding character as legal prescriptions set by a state or a similar legal entity), and they are set outside the foundation. In consequence, they cannot supersede sustainability parameters prescribed by the foundation statutes or the will of the founder. In the first instance, it is for the founder to say which investments he considers SRI; if he does not, then external SRI soft law can fill the gap.

Another aspect that can be decisive for the investment policy is the foundation's nature as capital preserving or capital consuming. As we have mentioned, the founder can allow for the foundation asset to be consumed in the process of purpose realization. If a foundation has such a capital-consuming structure and, in addition, an SRI purpose, the foundation board may even engage in SR investments that cannot be expected to return the invested capital.

3. Appropriate investment approach

As we have seen, SRI includes various investment approaches. Positive and negative screening, integrated investment, and active ownership can constitute valuable investment approaches for foundations. Yet the investment approach must be adapted to the structure and the possibilities of the foundation. Not all foundations possess the resources to engage in all kind of investments, particularly when it comes to demanding concepts like active ownership. If the foundation board chooses an investment approach that is too ambitious, the excessive demands

for time, manpower, and other resources may hinder the purpose realization of the foundation, and the board's decision may therefore be flawed.

But it is not only the foundation structure that preordains the appropriate investment approach. The foundation board must also, within the boundaries of foundation law and the foundation statutes, seek to establish working structures that foster the success of the foundation's SRIs. With regard to the particularities of the SRI sector, GRI-expert advisors or specialized committees within the foundation board may be instruments in these working structures.

Again: SRIs are a relatively new class of investments. The market for them is not as well-developed, well-structured, and well-evaluated as the markets for conventional investments. And SRIs often tend to present greater risks for the investor than conventional investments, e.g. because they are offered by recently established market players or because they are situated in developing countries. Asset management with regard to SRIs must therefore – not least for the avoidance of liability – employ a considerable degree of care and specific knowledge in order to make sure that the investments chosen are indeed SRI and that unnecessary risks and losses are avoided.

4. The foundation-planning perspective

Whether and how a foundation can invest SR is not only a question of the *ex post* interpretation of its statutes and the will of its founder. From the *ex ante* perspective of a prospective founder, the SRI activities of a future foundation become a question of foundation planning. From this *ex ante* perspective, the foundation statutes and the will of the founder are the crucial determinants for a sustainability orientation of the foundation. Although not many founders in the past addressed a possible SRI dimension of their foundations, this picture seems to be changing. It is for the protagonists of the sustainability approach to make the most of this new receptiveness by informing and supporting possible founders on sustainability matters.

Today's founders who wish to construct their foundation with an SRI dimension have to consider manifold legal, economic, and factual aspects. Although it is impossible to provide a comprehensive guide to planning an SR-investing foundation here, we would like at least to point out three maxims that are vital in the construction of any foundation, including an SR-investing one: First, a founder should seek expert advice. Here, this includes expert advice not only on foundation law but also on SRI aspects. Second, a founder should be explicit and clear in the fundamental precepts for the foundation. If you want your foundation to invest SR, then say so! And third, a founder should show a degree of humility with regard to the future. You will not be able to foresee the investment conditions and details of the situation of your foundation ten, twenty, or even hundred years from now; so, if you predefine investments in every detail, you may do your foundation more harm than good.

V. Resulting remarks on the model cases

Trying to apply the results of this article on our model cases we can, with regard to the "hospital foundation," assume that the foundation board is most probably allowed to invest SR. Yet, referring to the aforementioned classification of foundations with regard to their statutory basis for SR-investments, the foundation is part of the third group of foundations as it has no distinct statutory basis for SRI. Accordingly, the foundation board is probably allowed to invest SR, but it must (in principle) not accept underperformance in investment parameters (return, risk,

liquidity) stemming from the SR character of its investments. When deciding on whether and how to invest SR, the board will have to exert its discretion very thoroughly. The board must seek expert advice and construe the management of the investment appropriately. Exercising this level of care will not be easy, but if the board manages to show due care, it probably cannot be held liable for a possible failure of the investment.

Because of its SRI-related purpose element, our solar foundation falls in the first category of foundations in the statutory SRI-basis matrix. To choose a solar field-investment, therefore, does not in itself violate foundation law or the foundation statutes. But the foundation board may have unduly exerted its discretion, and thereby violated foundation law, by choosing a solar investment field that presents an inappropriate risk-return ratio. As the foundation is not intended to be a consuming foundation, the board has to secure the long-term realization of the foundation purpose. The chosen solar field-investment may not fulfill this obligation as it creates a great risk of severe financial losses and thereby endangers the entire foundation. Furthermore, insofar as the foundation board could have prevented the mismanagement, it has probably violated its obligation to carefully implement its investment decisions.

VI. Summary

1. General summary

As we have seen, the interaction of general foundation law and general investment principles with the particularities of SR investments is a complex but unavoidable topic for foundations that want to invest or have invested sustainably. Although the academic discussion has not yet consolidated towards a comprehensive and coherent set of legal rules for the management of foundation assets, some cornerstone principles” can guide foundation boards in assessing sustainable investments.

This assessment must start from the fact that the foundation assets are a core element of the foundation structure, because it provides the means to realize the foundation purpose and the will of the founder. Although the foundation board has a certain margin of autonomy and discretion, this margin ends where either binding prescripts are made by the law or the foundation statutes, or where the management and use of the foundation assets deviate from the orientation towards the foundation purpose and the will of the founder.

In order to exercise its discretion properly, the foundation board must follow a four-step process of (1) determining the margin of discretion, (2) assembling the relevant and sorting out the irrelevant aspects for the decision to be taken, (3) weighing the relevant aspects, and (4) taking and implementing a decision that reflects the result of the consideration process. These rules for a due consideration process are of very high importance to the management of foundation assets, not least because foundation boards typically exercise a margin of discretion with regard to many asset-management issues.

The aspects which are typically relevant for foundation asset management, in particular when it comes to the due exertion of discretion, can be separated into two categories. On the foundation level, we can locate the aspects that derive from fundamental principles of foundation law and from the structure of the foundation. On the investment level are general investment principles that apply – in principle – to the management of any asset, not only the foundation asset. This model helps to clarify the relation between the aspects assigned to the different levels: As the foundation board is bound to realize the foundation purpose and the relevant will of the

founder, the foundation level takes, in principle, precedence over the investment level. One example of the interaction of the two levels is the principle that foundations can and even should take appropriate risks when investing the foundation capital; core elements for determining which risks are appropriate are the structure of the foundation (foundation level) and the techniques of modern portfolio management (investment level).

Applying these general principles to SR-investing foundations and having regard to the statutory basis for an SRI, it seems necessary to distinguish three types of foundations: For the first group of foundations, whose purpose contains an SRI element, engaging in SRIs directly realizes the foundation purpose. The SRI activity is therefore not only possible, but mandatory. Yet the SRI purpose must be realized lastingly and in the best possible way, and not through idealistic but highly risky investments. For the second group of foundations, whose statutes, including the relevant will of the founder, address SRI activities without making them part of the foundation purpose, much depends on the way the SRI issue is addressed. If, for example, the foundation board has a large margin of discretion over how to execute SRIs, the two-level structure of relevant asset management aspects comes into play. According to this structure, the foundation board must conceive the SRIs in a way that best serves the foundation purpose, even if ESG factors advocate a different investment policy. For the third group of foundations, whose statutes do not mention SRI activities, it is not self-evident that the foundation board is allowed to invest SR. Even if an interpretation of the statutes and the will of the founder shows that the foundation can invest SR, no negative impact on the realization of the foundation purpose can be justified by SRI particularities.

If a foundation board is allowed or obliged to invest SR, then soft law, such as the ESG parameters and GRI guidelines, can help to determine whether an investment is SR. In consequence, this soft law is a major aspect of the foundation board's exertion of discretion over which investments to choose. Among the different SRI approaches, the board has to choose an approach adapted to the characteristics and the resources of the foundation. And the board has to establish working structures that foster the success of the foundation's SRIs. As SRIs are a relatively new class of investments that tends to present greater risks than many conventional investments, asset management with regard to SRIs must employ a considerable degree of care and specific knowledge in order to ensure that the investments chosen qualify as SRI and that unnecessary risks and losses are avoided.

From the *ex ante* perspective of a prospective founder, the SRI activities of a future foundation become a question of foundation planning. The foundation statutes and the will of the founder are the crucial determinants for a sustainability orientation of the foundation. In shaping the SRI dimension, the founder should observe – among many other relevant elements – the fundamental maxims of (1) seeking expert advice, including over SRI matters, (2) clearly prescribing the SRI policy, whilst (3) forbearing from regulating each and every detail of future SR investments.

These cornerstones of SR-oriented asset management for foundations will have to be elaborated in the future. Nonetheless, three “Charta”-principles may serve as a starting point for further discussions on the issue.

2. Elements of an SRI Charta for foundations

(1) The SRI activity of a foundation must take into consideration the fundamental principles that follow, on the foundation level, from foundation law as well as from the statutes

of the foundation. Moreover, it must respect, on the investment level, the general rules of asset management. In principle, the foundation level takes priority over the investment level.

(2) Foundations with SRI as their purpose are, like all foundations, bound to realize that purpose as best possible. The SRI activity of other foundations depends on whether and how the foundation statutes conceive a specific (SR-) investment strategy; in any case, the SRI activity must be shaped in a way that does not hinder the optimal realization of the foundation purpose.

(3) Foundations shall apply due care in taking and implementing their investment decisions. This includes, in particular, the foundation board's duty to abide by the rules of a due exertion of discretion. SRI decisions shall, as part of a due exertion of discretion, take into consideration commonly accepted guidelines and criteria on how to determine the SR character of an investment. The SRI approach must be adapted to the structure and the possibilities of the foundation.

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